# Market Briefing: March 2023

*Key developments in the housing and mortgage markets*

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## Executive summary

- The UK economy has performed better than expected in recent months. First estimates of GDP growth in Q4 showed output flat, meaning the economy just avoided entering a technical recession after Q3's fall of 0.2%, itself revised down.

- CPI inflation rose unexpectedly to 10.4% in February from 10.1%. But hopes that inflation will fall back sharply this year have been buoyed by lower commodity prices, which have already fed through into producer input prices, which turned negative on a 3-month comparison in January for the first time since July 2020.

- Less positive for the outlook for inflation, wage rises continue to pick up, the largest shift in recent months being a steeper rise in public sector pay after it had lagged well behind the private sector. Regular pay in the public sector rose 4.8% in the November-January period although private sector pay is still growing faster at 7.0%.

- Given the lags involved in the home buying process, it is unsurprising that the shock to buyer confidence and spike in mortgage rates that followed the mini-budget were not obvious in either transaction levels or house price data up to the end of 2022. But transactions were below 80,000 in both January and February and the RICS Residential Market Survey for February shows that both price and sales expectations are heavily negative, though slightly improved on January. However, falling vendor instructions and low levels of homes on the market should temper future house prices falls.

- Fixed term mortgage rates have eased back since their highs of October, following the gilt market's adverse reaction to the mini-budget and the announcement that the Bank of England would begin selling gilts bought under its QE programme. The largest falls have been with 5 year deals, with some falling below 4% in February.

- Despite the return of stability to the mortgage market and improving fixed rates, approvals both for home purchase and remortgages fell very sharply in December and January. Comparing the 3 months to January with the previous 3 months, both house purchase and remortgage volumes were down 48%. This largely reflects the market disruption that followed the mini budget given the lags in the mortgage process and points to a period of weak lending in the months ahead.

## The economy

First estimates for GDP in the fourth quarter were better than expected, with overall output flat, enabling the economy to avoid a technical recession, despite a 0.5% fall in output in December. On a sectoral level, the services sector was flat, production down 0.2% and construction up 0.3% on Q3. Within the components of demand, private consumption was up 0.1% despite squeezed living standards while government consumption and government and business investment we all higher. Net trade made a negative contribution due to a fall in exports.

As Chart 1 shows, the monthly profile of GDP has been quite volatile lately but January performed well with a rise of 0.3%, buoyed by the services sector. Production was down 0.3% while construction saw a much larger fall of 1.7%, the weakest performance since June 2022 with infrastructure and private house building showing large falls.

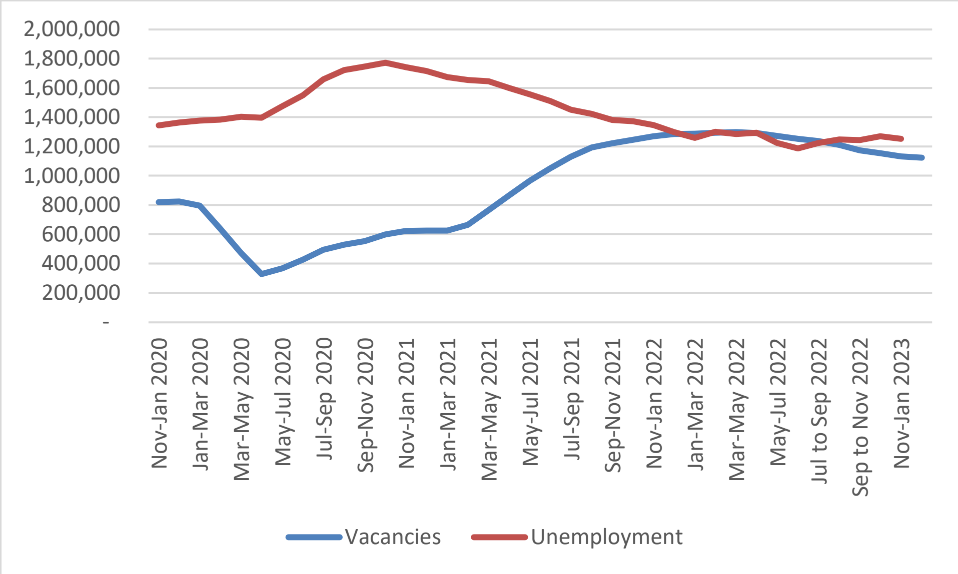
**Chart 1 – Sources of GDP growth %**


Source: Office for National Statistics

### Labour market

The slight softening of the labour market of recent months has continued. In the December to February period, vacancies were down 9,000 to 1,124,000 while unemployment has risen by 65,000 since last summer (see Chart 2). The unemployment rate, however, has remained unchanged for the past four months at 3.7%, only marginally above its 47-year low of 3.5% of July 2022.

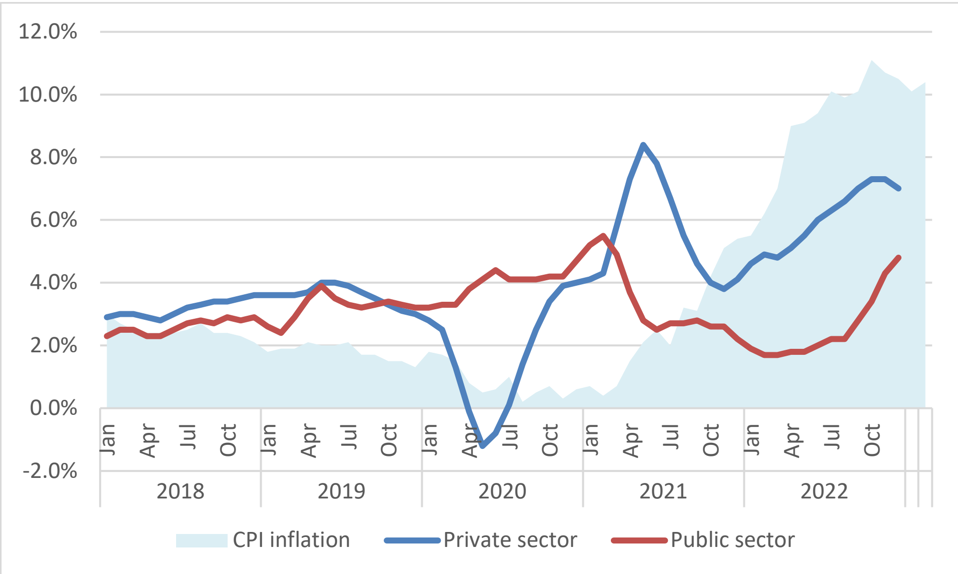
**Chart 2 – Job vacancies and unemployment**




Source: Office for National Statistics

Wages continue to lag inflation as measured by the CPI (See Chart 3). While private sector regular pay growth fell slightly to 7.0% in the November-January period, public sector wage growth has picked up markedly to 4.8% (as recently as July-September it was 2.2%), providing clear evidence that the government's previously tough line on pay settlements for its workforce has softened.

**Chart 3 – Regular pay growth in the public and private sectors**



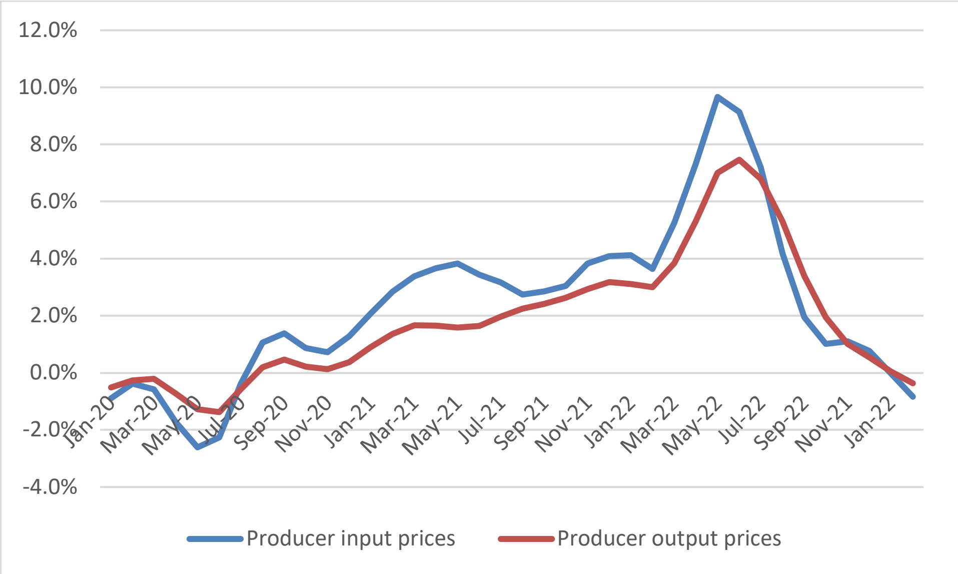

Source: Office for National Statistics

With the Office for Budget Responsibility (OBR) forecasting that CPI inflation will be 2.9% by the fourth quarter of this year, wages could soon start rising again in real terms, which should underpin consumer spending. Workers are likely to push for a period of rising real wages to claw back the falls of the past 12 months, so against the background of a still tight labour market, there may not be a rapid decline in nominal wage growth. With weak productivity growth, continued high pay increases could delay Bank of England interest rate cuts even if inflation falls back to target, as the OBR expects it to in Q1 2024.

**Inflation and interest rates**

Global commodity prices have fallen in recent months. According to the GSCI Commodity Index, prices are 32% below their June 2022 peak, although still 23% above the 1st January 2020 level. UK spot natural gas prices, which have played a critical role driving domestic electricity prices higher, are now 84% below their 2022 peak but still more than double their pre-pandemic level.

**Chart 4 – Producer input and output prices (3 month on previous 3 month)**

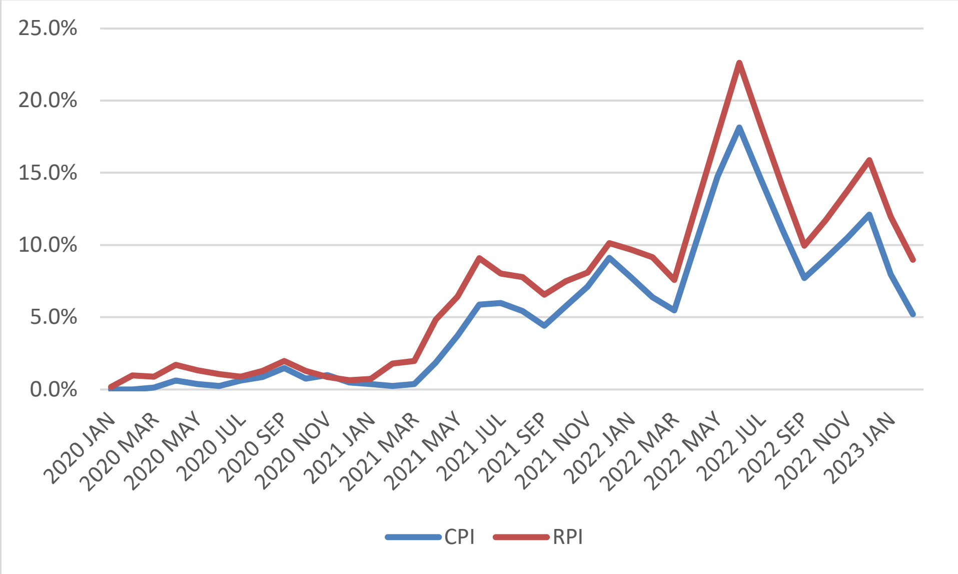



Source: Office for National Statistics

Falling commodity prices are reflected in a fall in producer input prices of 0.8% in the 3 months to February compared to the previous three months (see chart 4). Producer output prices turned negative for the first time since July 2020 despite rising labour costs, suggesting that firms are compressing margins to maintain sales.

CPI inflation remains persistently higher and edged up in February to 10.4% from 10.1% the previous month and a peak of 11.1% in October. The RPI index shows a similar trend. But taking the latest 3 months compared to the previous 3 months, as Chart 5 does, CPI inflation was running at an annualised figure of 5.2% in February, the lowest rate since September 2021. The rise in CPI inflation in February was, no doubt, a factor in the Bank of England's decision on 23 March to raise Bank Rate to 4.25% by a 7-2 majority. The dissenters favoured no change in rates.

**Chart 5 – CPI and RPI annualised 3 month on previous 3 month average inflation**



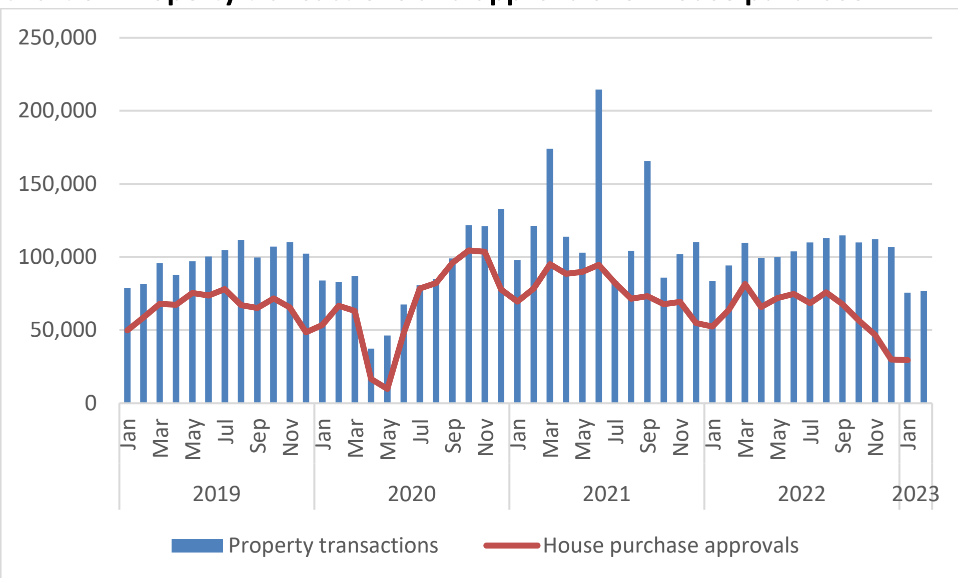

Source: Office for National Statistics

## Housing and mortgage markets

### Activity

The sudden loss of confidence in the housing market that followed turmoil in the government bond (gilt) market in the wake of the mini-budget and the Bank of England's announcement that it would start selling gilts bought under its QE programme was hard to discern in the data up to the end of 2022. Housing transactions remained above 100,000 a month in October, November and December. But this just reflected the length of the house buying process and in January the impact started to show, with transactions down to 76,000, 29% below December's figure (see Chart 6). February's figure showed a slight rise to 77,000.

**Chart 6 - Property transactions and approvals for house purchase**




Source: HMRC, Bank of England

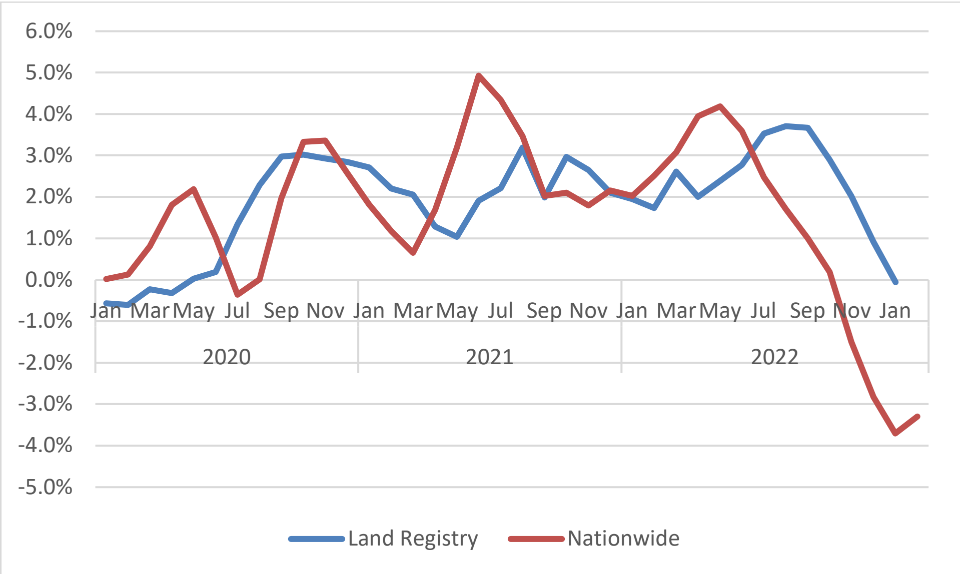
The RICS Residential Market Survey is a more timely indicator and it showed a rapid fall into net balances reporting lower sales agreed, buyer enquires and sale prices from last Autumn. Improved sentiment provided by falling fixed rate mortgage pricing since October has produced a slight bounce in February from the lows recorded in January but the numbers remain heavily negative. New vendor instructions have also shown negative balances, though not as large, so despite lower buyer enquiries, the stock of properties for sale remains close to its all-time lows. This is likely to support house prices, making a severe contraction improbable.

Mortgage approvals, though not reacting as quickly as the RICS survey to a change in sentiment, do tend to lead transaction figures by 2-3 months and they have experienced a severe drop since September. In the 3 months to January, house purchase approvals were 48% down the previous 3 months. January's figure was £5.9 billion, the lowest monthly figure since the first Covid lockdown and 62% below September's.

**House prices and rents**

House prices are also a lagging indicator and the Land Registry figures did not show a material fall up to January but the Nationwide figures are somewhat more timely and these have seen a rapid reduction in annual house price inflation from double digits as recently as August to -1.1% in February. On a 3 month on previous 3 month basis, as Chart 7 Shows, the Nationwide Index has been negative since November reaching -3.3% in February, an annualised rate of decline of 14%.

**Chart 7 – House price inflation (latest 3 months on previous 3 months)**




Source: Nationwide Building Society, Land Registry

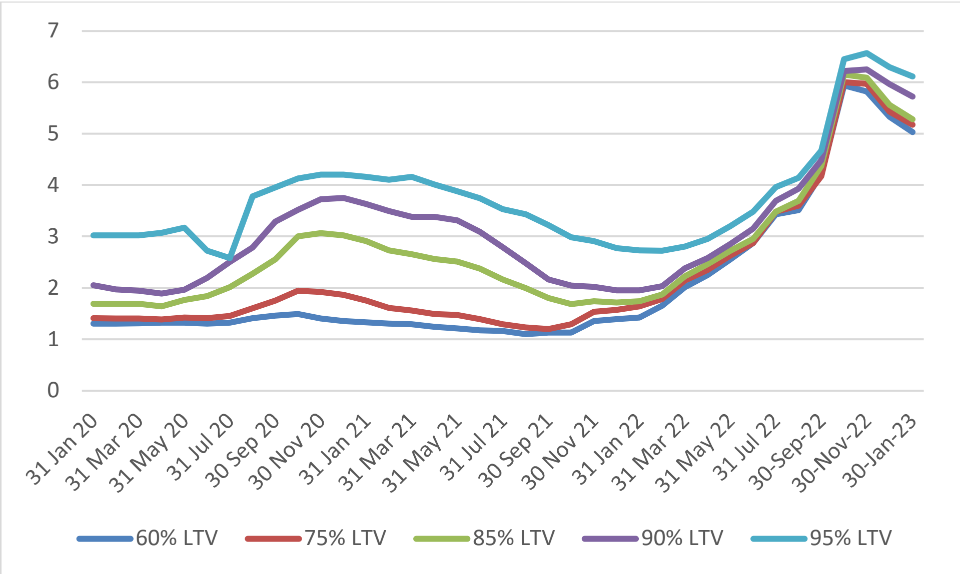
In contrast to house prices, rents continue to show substantial increases. The February Homelet Rental Index showed rents rising by 10.2% over the previous 12 months, roughly in line with broader CPI inflation. In contrast, the government private rental series was up a more modest 4.7% in the year to February. The difference reflects the fact that the government series tracks existing rents while Homelet tracks newly agreed tenancies. This suggests that landlords are insulating existing tenants from the full impact of rising market rents. Calls from London mayor Sadiq Khan and others for a private sector rent free may well lead such landlords to reconsider a strategy of shielding existing tenants from rising market rents as they would be most exposed in the event of a rent freeze.

The February RICS Residential Market Survey showed a balance of +32% of contributors reporting higher tenant demand, although the trend in this number has been down in recent months, and at the same time contributors reporting lower new landlord instructions was -13%. Unsurprisingly then, rents are expected to rise further by +45% of respondents.

**Mortgage pricing and products**

Fixed rate mortgage pricing has continued the positive trend seen since November, after the extreme market volatility of late September and October. As Chart 8 shows, average 2 year fixed rate mortgage pricing has improved across the LTV spectrum but remains well above the average rate seen in the first half of 2022. The same picture is true of longer term fixes with the cheapest 5 year fixes falling below 4% in February.

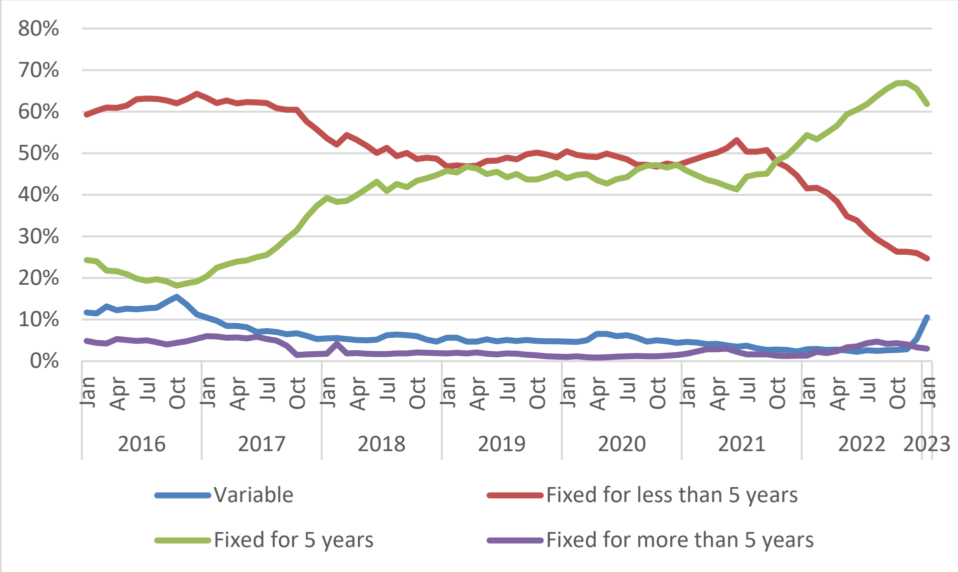
**Chart 8 – 2 year fixed rate mortgage pricing**




Source: Bank of England

In contrast, variable and tracker mortgage pricing has been rising, reflecting rising Bank Rate. There was an increase in the share of variable rate loans in January to its highest level since 2016, as Chart 9 shows, but this no doubt reflected the improved competitiveness of such deals in the aftermath of the mini-budget when fixed rates spiked. With a downward sloping yield curve from short term rates to 5 year money, 5 year fixed rate mortgages are likely to maintain their appeal and market share going forward.

**Chart 9 – Fixed and variable rate share of new lending**

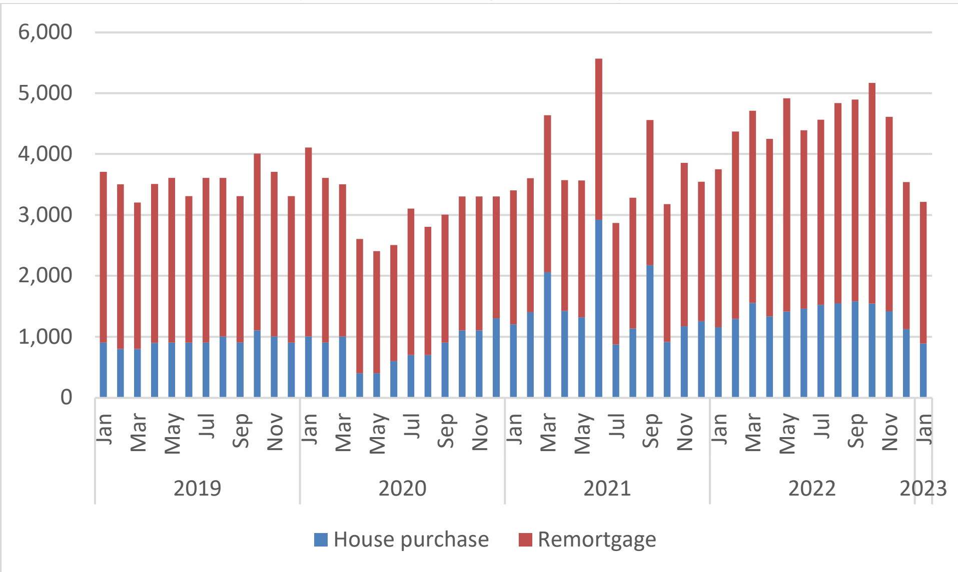



Source: UK Finance

## Buy-to-let market

Buy-to-let lending slowed more sharply at the end of last year than lending to owner-occupiers. This may reflect the fact that buy-to-let investors are quicker to respond to changing market conditions. Also, the spike in mortgage rates following the mini-budget pushed rates so high that many landlords found that they were unable to meet affordability requirements when they came to remortgage. Search criteria firm Mortgage Broker Tools reported that in November a record 19% of landlord enquiries failed to find any lender prepared to offer the size of loan required.

**Chart 10 – Value of buy-to-let lending (monthly £ millions)**




Source: UK Finance

In January, house purchase lending was down 44% compared to September and remortgaging down 30% (see Chart 10). We are likely to see further falls in buy-to-let lending given the lags involved but as with the mainstream market, rates have come down so affordability issues have eased, which should help lending volumes to stabilise during the course of this year barring any unforeseen shocks.

In February, the Levelling Up, Housing and Communities Committee published its report *Reforming the Private Rented Sector*, their response to government proposals outlined in the White Paper *A Fairer Private Rented Sector*, published in June 2022.

The committee supports the proposal to abolish Section 21 of the 1988 Housing Act, which allows landlords to evict tenants at the end of a fixed contract period without cause but argues for an exception in the case of student housing. It also supports the government's proposals to make it easier for landlords to evict under Section 8 with the proviso that it considers that grounds to evict based on the landlord's desire to sell or occupy the property could be used as a backdoor to no fault evictions and therefore proposes extending the period at the start of a tenancy before such grounds could be used from 6 months to 1 year.

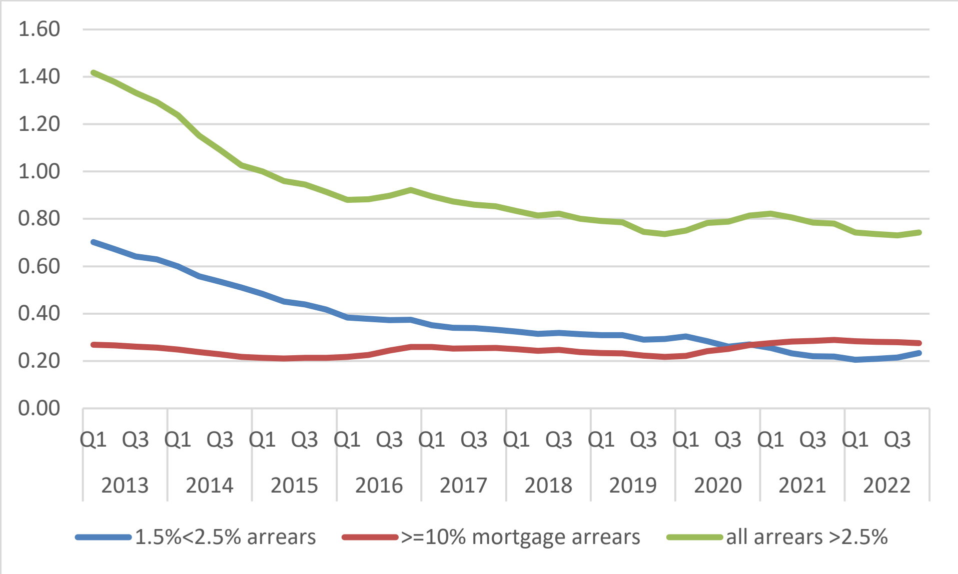
The committee is concerned that the proposed changes would add to the court system's workload, leading to unjustified delays for landlords seeking eviction. It therefore proposes a special housing court but barring that it wants the government to ensure that courts prioritise and fast-track all possession claims in respect of rent arrears and antisocial behaviour.

The committee supports the government's proposal to introduce a legally binding minimum Decent Homes Standard (DHS) and a mandatory register of all rented properties through a portal. It is also proposing a single private rented property ombudsman service covering both letting agents and landlords in preference to the government proposal for a separate scheme for landlords.

**Arrears and possessions**

Mortgage arrears figures for the end of 2022 show no real sign of rising stresses amongst borrowers despite the cost of living crisis that has received so much attention. As Chart 11 shows, the proportion of borrowers in the highest arrears bracket (10% or more of loan balances) did rise quite sharply in 2020 but has remained constant since at 0.28%. Overall arrears have performed better, with the ratio falling back to its pre-pandemic low of 0.74%.

**Chart 11 – % of mortgages in arrears (by percentage of balance)**




Source: UK Finance

With future household energy costs less of a concern than they were just a few months ago due to falling wholesale gas prices and the government's decision to extend energy support for households until July, the possibility that we could avoid a sharp rise in arrears cases this year has risen considerably. The improved outlook relative to the position last year should also have a knock-on effect on the outlook for repossessions. Although the number of repossessions was up sharply in 2022 to 3,920, the fourth quarter figure was down 23%, and the annual total still represents an extremely modest figure by historical standards, the average of the last 15 years being 20,000 a year.

## Prospects

The economic outlook has brightened somewhat since the start of the year as commodity prices have eased back. Despite the squeeze on real wages, the household sector has a strong balance sheet including higher level of cash reserves that accrued during Covid lockdowns, thanks to large transfers from the state. This appears to be sustaining consumer demand, which constitutes over 60% of the economy, as is the strength of the labour market, which has eased peoples' concerns about losing their job.

If OBR forecasts for inflation prove correct, real wages could be rising again by the end of the year, which should underpin demand. Fears of further interest rate rises have also moderated with the market expecting rates to peak at c.4.5% this year, with the recent rescue of Credit Suisse expected to make central banks more cautious about further rate rises. This points to the economy avoiding the severe recession many had forecast. The fact that global energy prices have come back a great deal is significant as high energy costs was the main concern driving weaker sentiment.

The outlook for the housing and mortgage markets is therefore not as negative as it was. Talk of a housing crash looks increasingly alarmist and, while a period of lower activity seems certain, the underlying factors that have kept house prices elevated remain in place, namely inadequate house building rates against the background of a rising population.

The mortgage market can also expect a period of lower activity but we would expect approvals to start to rise modestly over the coming months reflecting the return of confidence now that fixed rate pricing has settled down. While most households who need to refinance their mortgage this year will find their payments going up, it must be remembered that we have just exited an exceptional period when interest rates were kept artificially low. That provided homeowners with a windfall benefit but it is worth bearing in mind that a return to more normal conditions still leaves homeownership an attractive choice financially.